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Income Tax Return Preparers

Prepared by
Donald E. Milner
for
The Professional Organizations Committee

This internal working document was prepared for
The Professional Organizations Committee,
but the views expressed herein are those of the author
and do not necessarily reflect the views of the
members of the Committee or of the Research Directorate.

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Income tax return preparers

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Note: The abbreviation "CRP" ("Commercial Return Preparer(s)") is employed herein to refer to income tax return preparers such as H. & R. Block (Canada) Limited, as opposed to either (i) accountants and accountancy firms or (ii) social agencies which prepare personal tax returns without remuneration.

Note: Due to some difficulty in its acquisition, the information on the State of Oregon's regime for regulation of CRPs was received well after the initial completion of this document. That information has now been incorporated in the section entitled The American Experience.

CONTENTS

Introduction	... 1
Information Obtained from H. & R. Block (Canada) Limited	... 3
Services Offered	... 3
Pricing and Guarantees	... 4
Internal Structure	... 4
Quality Control	... 5
Complaints and Errors	... 7
The Market in General	... 8
Statistics	... 9
Data on the Market Share of CRPs from the Department of National Revenue	...12
Table 1: Number of Individual Tax Returns Prepared, by Author, 1975 Taxation Year	...15
Consumer Complaints Regarding CRPs Received by the Ontario Ministry of Consumer and Commercial Relations	...16
Consumer Complaints Regarding CRPs Received by the Better Business Bureau of Canada	...16
Consumer Complaints Regarding CRPs Received by the Federal Department of Consumer and Corporate Affairs	...17
Table 2: Records of Complaints Handled by the Consumer Services Activity of Consumer and Corporate Affairs Canada, 1973 to 1977	...20
Table 3: Detailed Compilation of Complaints Received, 1972 to	

1977, Consumer Services Section, Ministry of Consumer and Corporate Affairs	...25
Newspaper Survey of CRP Performance	...30
Table 4: Net Errors in Computation	...34
Table 5: Number of Errors per CRP	...35
Potential Abuses	...36
Improper Advertising	...36
Improper Pricing	...37
Unfair Contracts	...37
Unethical Behavior	...39
Illegal Behavior	...40
Negligence	...41
Failure to Perform Duties	...42
Missed Deductions	...42
Poor Advice	...44
Regulatory Approaches	...46
The American Experience	...48
Background	...48
The CPA Proposal	...50
California's Regulatory Regime	...52
Oregon's Regulatory Regime	...58
Some Suggestions for Further Inquiries	...64
Appendix: U.S. Federal Legislation Affecting CRPs	...66
Footnotes	...73

INTRODUCTION

The subject of this memorandum is commercial tax return preparers. Since annual tax returns may be prepared by just about anyone -- from the taxpayer himself to a licensed public accountant -- it is important to note that the subject is confined to a particular form of preparer. This can perhaps best be defined by example: H. & R. Block (Canada) Limited, presently the largest and most widely advertised CRP firm operating in Canada.

The typical tax preparer of the Block type would seem to provide basically one service: the preparation of annual returns. Whether a sole proprietorship, franchise, partnership or corporation, the CRP usually then performs three fundamental tasks: (1) gathering relevant financial and other information from the client; (2) applying the tax legislation and reporting rules to that information; and (3) mechanically completing the client's official return.

The materials presented herein are concentrated in two areas: (i) information on the present market for CRP services and (ii) consumer complaints concerning CRP services. In neither area is there much available information. For the former, little detailed data on the structure of the market exists, although rough estimates of business volume can be made. For the latter there is only fragmentary and anecdotal reporting. Firstly, using information obtained through an interview with an officer of H. & R. Block (Canada) Limited, a short sketch is provided of one CRP's activities, and, where possible, of the general market. Secondly, data from the federal Department of National Revenue on

the preparation on noncorporate tax returns (by "author") is set out. Thirdly, records of consumer complaints received by a few governmental and non-governmental agencies are outlined. This is followed by a review (in an abstracted sense) of the potential problems which might arise in relation to quality, advertising, pricing and so on in the CRP field. A very short summary is provided of the possible alternative modes of regulatory approach which might be considered if it were felt necessary to impose some form of quality control or other restraint on CRP services. By way of contrast, this is followed by a sketch of the U.S. experience with CRPs and CRP-related regulation, concluding with a description of the regulatory regime adopted in the State of California in the mid-1970's. Finally, a few suggestions for further inquiry are ventured. An appendix sets out in more detail the U.S. federal scheme of regulation.

INFORMATION OBTAINED FROM H. & R. BLOCK (CANADA) LIMITED

The ensuing profile was obtained through an interview with the Central Regional Director of H. & R. Block (Canada) Limited, presently the largest CRP operating in Canada. Block (Canada) is a subsidiary of a highly successful American parent corporation, which has approximately 8,500 offices in the U.S. and prepares 10 to 11 million tax returns each year. The interview was designed to obtain (i) an overview of Block's own operations and (ii) a picture of the return preparation market as a whole. On the latter point, the Regional Director was unable to provide very much information.¹

Services offered

Basically, Block offers two services: preparation of income tax returns and related schedules (both domestic and foreign) and training courses for preparers. Block does not consider itself to be a "consultant," and shies away from estate planning and judgmental tax advice. Information on "what the tax acts state" is provided as a free service. Obviously, determining what the tax acts entail may involve some exercise of judgment, although CRPs like Block are most likely to be called upon for rather routine information on non-complex subjects. Employees and franchisees will help a person to understand the various tax implications of (say) selling their home, but are encouraged not to tender any suggestions or advice on the most advantageous course to follow. The Regional Director stated that Block's preparers are not trained or competent to deal with estate planning-type matters.

Pricing and guarantees

Block prices its services according to the complexity of the return. That is, the number of steps which most be completed determines the charge. Simple returns are prepared for roughly \$5 to \$20; much more complex matters (e.g. where a home is sold or marital status has changed or there are many sources of income) might result in a charge of \$25 to \$50.

Block guarantees that its customers will ultimately pay no more than they are legally required to pay, in the sense that Block will pay any fines and/or interest payments levied against the taxpayer as the result of an error by Block. The guarantee is directed to the kind of situation where as a result of Block's calculation their clients submit a certain amount or request a certain refund which proves to be incorrect. The client pays the difference in taxes and Block pays any penalty incurred (e.g. for late payment). The Regional Director indicated that people sometimes misconstrue the guarantee -- expecting Block to pay both fines and interest and any tax owing -- but this is not frequent in his experience. He also indicated that Block occasionally pays penalties or returns the client's fee in cases of alleged mistake even though Block feels that the error was the client's fault. The Block guarantee does not cover possible reliance losses -- e.g. where the client indicates that, on the basis of an expected refund which turned out to be incorrect, he or she (say) purchased something. Only the fine or interest levy is paid, and occasionally the client's fee is returned as a public relations gesture.

Internal structure

Block sells its services to the public in three ways. Firstly, in large urban centres Block operates offices directly, some of which remain open all year round, and others of which are open only for about three months

preceding the annual filing deadline for individual returns (the peak season). Secondly, Block operates a few offices under contractual arrangements with department stores, opening service centres in the stores for the peak season. Thirdly, Block enters franchise agreements, under which franchisees pay a royalty for the use of Block's name, operate there under, and benefit from Block's general advertising campaigns. There are Block operated offices in most of the major urban centres of Canada. There are twenty Block outlets in Metropolitan Toronto, of which some are open all year. Franchises may operate in urban areas, but are mostly one-man concerns located in rural and semi-rural areas which are open only for the peak period. There are roughly 180 to 250 franchises presently outstanding. Because franchises in small population centres tend to be operated as part-time businesses -- some being located in the franchisee's living room -- their number fluctuates from year to year.

Block's employees and franchisees are recruited from its own training courses. These are offered either as correspondence courses or as residence programs wherein students attend regular classes. There is an initial course, which in its residence version may require three months of three sessions per week. After the initial course, trainees may enter into a further program of roughly equivalent duration designed to prepare them as employees or possible franchisees. The Regional Director indicated that it is hard for Block to retain employees, especially since many offices are only open during the three-month peak period. Block relies heavily on "housewives," retired persons and seasonal workers as sources of manpower.

Quality control

Essentially, Block relies for quality control on its training

programs. Further supervision is provided in one of two ways. First, for the larger offices, preparers' work is re-checked by senior personnel. Second, for the smaller, often one-man, rural offices Block employs "shoppers." These individuals, unknown to the operators, present themselves at the offices with "dummy" information and forms. They are expected to test both the quality of the service received and the integrity of the preparers (e.g. by suggesting that a source of income be omitted from the declaration). These spot checks are conducted at random, although their frequency would be related to the incidence of problems with a particular operator. There is provision for termination of a franchise for improper activities.

Block sees quality as having four components: recognition of situations with possible tax implications, inclusion of all income, inclusion of all legitimate deductions and proper calculation. Aside from training its personnel in the tax acts (primarily for personal income tax), Block relies heavily on its own form of the tax return. The Block form consists of a more detailed version of the standard return. For example, where the official return contains a moving expense deduction, the Block form will provide a breakdown of all the usual types of expense which fall under that heading. Preparers use the Block form in the client interview, and are encouraged not to rely totally on the client to bring up possibly important points. Totals from the Block form are then transferred to the individual returns. In the larger offices the latter task will be performed by secretarial personnel and the client must usually return to the office to obtain a final copy of his tax return.

The Canadian arm of Block does not presently use computers, although

they are being experimented with in the U.S. Because of the Canadian volume of business, the Regional Director suggested that they would not be very cost-efficient in the Canadian operation. He stated that cost-efficiency increases would have to be very substantial before computers would be adopted, because they tend to depersonalize service to some extent. As an example, he indicated that if data had to be shipped from each office to a processing centre, the client could not as easily be given a rough indication of his situation at the interview itself. Presently, the client has a general idea of his situation at the interview, even if he must return for the final version of his tax return later, which the Regional Director says as a positive element.

Complaints and errors

According to the Regional Director the incidence of consumer complaints is not high. Block takes the position that many of the reported "errors" are in fact created by the client -- e.g. through failure to declare certain income, the provision of incorrect figures and so on. He suggested that "true" Block errors -- e.g. miscalculation, or transposition of figures to the wrong entries -- occur in approximately one tenth of one percent of cases, and that many such mechanical errors are detected by the DNR's computers. These errors he attributed mainly to human carelessness on the part of employees faced with a large volume of very repetitious tasks. The incidence of error seems to be correlated with the volume of business, peaking in the few weeks before the filing deadline when most customers come in. The Regional Director stated that the use of computers would probably eliminate a large portion of miscalculation and transposition errors.

Almost all complaints are dealt with by the individual offices. The Regional Director indicated that the vast majority of complaints are satisfactorily resolved. He also stated that he personally receives about six complaints per year, and that his name and office address is available to customers.

The market in general

The Regional Director could offer little detailed information on the market for return preparation, the number of Block's competitors, etc. He did state that Block received no significant competition from public accountancy firms, suggesting that such firms have no interest in small return preparation, particularly since the sharp increase and decline in business volume within a four to eight week period would interfere with their usual business operations. Anecdotally, he indicated that one (unnamed) public accountancy firm in London, Ontario posted a large sign in its entrance room stating that minimum charges for return preparation were \$25 and up and its receptionists referred small clients to the local CRPs.

The information obtained concerning Block's own share of the market is contained in the following section, headed "Statistics." In general, the Regional Director indicated that Block's major competitor is the self-filer, who must be persuaded of the convenience advantages of a preparation service. He felt that this is not easy to do in Canada, where the standard individual tax return is relatively easy to prepare -- there being, for example, a very limited number of available deductions. He also indicated that Block feels the urban market is relatively saturated, so that little, or very slow, expansion is expected. On the other hand, he stated

that there was some greater room for growth in rural and semi-rural areas, although it is hard to sustain an agency with a small population base. Block apparently encourages its franchisees to be more aggressive in marketing their services, and the following "success story" anecdote was related:

A one-person franchise in Goderich, Ontario (population under 10,000) is operated out of the franchisee's own home. This operator speaks to women's clubs, donates a prize for the annual Fall Fair, etc., and now does approximately \$40,000 (gross) business each year. The franchisee also informs local and surrounding-area lawyers of her availability for individual tax return preparation, and as a consequence now does a major part of the lawyers' preparation work in the area on a sub-contractual basis.

Statistics

The following data was provided. All figures are approximate totals.

1. In 1977 10% of non-corporate return preparation in Canada was performed by CRPs. (Block receives the same data from the DNR as was supplied to the POC.)

2. Block itself prepares approximately 800,000 to 1 million tax returns per year.

3. About 90% of Block's business is generated by household, individual tax returns. Of this 90% the majority fall within the lower half of the income scale. The remaining 10% is generated by small businesses, farm businesses, estate returns, etc. Block does no major corporate return preparation to speak of. Although no breakdown was available, it seems

safe to surmise that the small business returns would involve primarily unincorporated companies, sole proprietorships, etc. Block does not expect this situation to change, and is making no effort to expand into corporation return preparation in general.

4. Roughly 75% of Block's customers are repeaters. The remaining 25% are either one-time or off-and-on users. Of that 25% a large portion is made up of persons who are facing an isolated or infrequent complication or change in their tax situation (e.g. a change in marital status or the sale of a residential property) and otherwise do not use a CRP's services. Block concentrates its sales efforts on making up that 25% each year and retaining its 75% repeat business rather than attempting to significantly expand total volume.

5. About 75% or more of Block's business is done in a period of four -- eight weeks immediately preceding the filing deadline. There is a further rush of business in the last week or two, a large portion of which seems to be made up of persons who have kept erratic or inadequate records or otherwise present special difficulties. Block apparently tries to persuade its customers to return a bit earlier next year.

Block keeps no detailed information on the number of its competitors or their individual share of the market. The Metropolitan Toronto directories indicate (for 1978) that 100 offices are listed under the heading "Tax Return Preparation." Of this 100, Block offices number 20. The next largest number is 18 offices for Beneficial Finance System (a consumer finance company). Most firms list only one office, with some listing two or three locations. None of the offices listed belong to

major public accountancy firms. Among the interesting forms of service indicated in the directory are "Tax Return by Telephone (TRT) Canada Limited" ("As Near as the Phone in Your Home") and "United House Call Income Tax Service" -- neither of which services are offered by the two major firms.

Interestingly, if Block's estimate that they prepare 800,000 to 1 million returns a year is accurate, it can be said that Block has cornered a very large portion of the national market. Assume for the moment that Block prepares 800,000 returns, 95% of which are individual (noncorporate) returns. If this figure were taken as Block's portion of the approximately 1,185,000 returns prepared by CRPs for 1975 (see infra. and Table 1) -- i.e. 760,000 out of 1.2 million -- this would suggest that Block had roughly 2/3rds of the market for personal return preparation in Canada.

DATA ON THE MARKET SHARE OF CRPs FROM THE
DEPARTMENT OF NATIONAL REVENUE (DNR)

In an attempt to determine the share of the Canadian market for return preparation garnered by CRPs, the POC contacted the federal DNR. The fruits of that inquiry are found in Table 1 (following). This supplies a breakdown of the preparation of returns for the 1975 taxation year by "author," for three provinces (Ontario, Alberta and British Columbia) as well as for Canada as a whole.²

Four important reservations apply to this data. Firstly, Table 1 does not include corporate returns. Unfortunately, the DNR was not able to supply a similar breakdown for that area. While it might be expected that few, if any, corporations would avail themselves of CRP services, it would be interesting to know whether CRPs attract some business from small concerns (e.g. one-man service corporations, etc.). The conclusion that very little corporate return preparation of any kind is done by CRPs is supported by the experience of H. & R. Block (see supra.). Secondly, the figures given do not include preparation of returns for persons required to file in a foreign jurisdiction (e.g. a Canadian resident employed in the U.S.). However, while H. & R. Block indicated that its offices in the Detroit-Windsor area provide such services on a fairly regular basis, the volume of this business is unlikely to be very high overall (see supra.). Thirdly, Table 1 does not include reassessments. Since the level of errors, omissions, etc. associated with CRPs is of interest, the inclusion of reassessment cases -- or a separate breakdown for that area -- would have been useful. Fourthly, these are sampled statistics only. The reliability of the

data is therefore somewhat less than totally satisfactory. In addition, the data covers only one taxation year. It would have been interesting to have had some indication of the growth or decline in CRPs' business for an extended period, particularly since CRPs are a relatively new phenomenon. It should be mentioned in this regard that, on the basis of similar DNR statistics for more recent taxation years, Block's Regional Director indicated that its share of the market between 1975 and 1978 has remained relatively stable (see supra.).

Given the data as it stands, the following general conclusions can be stated. Self-filers account for roughly 60+ to 70% of returns. CRPs, accountants and "others" (e.g. family, friends, nonprofit agencies, etc.) account in fairly equal portions for the remaining 30 to 35-%. The largest variations occur in Alberta, where self-filers make up only about 64%, compared with 70% and 69% in Ontario and B.C. respectively and 71.5% nationally. This approximate 6% difference seems to have been absorbed by accountants who handled about 18% of returns, compared with 10% and 13% in Ontario and B.C. respectively and 10% nationally. The use of CRPs remains at about the 10 to 11% level throughout. (All other variations between provinces and on the national scale are within much closer limits -- e.g. 1 to 2%.)

Due to the sheer number of individual taxpayers, the 10 to 11% share is not insignificant. It is estimated that roughly 1.2 million returns were prepared by CRPs for the 1975 taxation year. By way of contrast, however, the Canadian figure should be compared to the U.S. estimate that at least 25% of returns are prepared by CRPs nationally,³ and the California estimate that 50% of the returns prepared in that state are

prepared by CRPs.⁴

Finally, it is regrettable that the POC was unable to obtain a preparer breakdown cross-referenced to levels of gross, net, taxable or after-tax income. It would be interesting to have some indication whether the 10 to 11% of filers who rely on CRPs come predominantly from any particular income bracket(s). It should be noted that the experience of H. & R. Block supports the conclusion that the majority of CRPs' clients are concentrated in the lower regions of the income scale (see supra.).

NUMBER OF INDIVIDUAL TAX RETURNS PREPARED, BY AUTHOR^{*}

1975 TAXATION YEAR

<u>Province</u>	<u>Tax Services</u>		<u>Accountants</u>		<u>Self-Filers</u>		<u>Others</u>		<u>Total</u>	
	<u>No.</u>	<u>%</u>	<u>No.</u>	<u>%</u>	<u>No.</u>	<u>%</u>	<u>No.</u>	<u>%</u>	<u>No.</u>	<u>%</u>
Ontario	540,317	10.95	469,839	9.52	3,470,410	70.35	452,634	9.18	4,933,200	100
Alberta	105,669	10.88	173,944	17.90	620,900	63.90	71,145	7.32	971,658	100
British Columbia	150,779	11.40	175,181	13.25	907,330	68.63	88,855	6.72	1,322,145	100
All Canada	1,185,333	9.87	1,243,330	10.35	8,539,390	71.53	989,729	8.24	12,007,782	100

TABLE 1

SOURCE: 1975 SAMPLED ADMINISTRATIVE STATISTICS, DEPARTMENT OF NATIONAL REVENUE

^{*} Note: Does not include (i) corporation returns
(ii) re-assessments

CONSUMER COMPLAINTS REGARDING CRPs RECEIVED BY
THE ONTARIO MINISTRY OF CONSUMER AND COMMERCIAL
RELATIONS (CCR).

The CCR indicated to the POC that its present categorization of complaints does not identify complaints against CRPs or accountants as separate classes. The Ministry did state that it was the consensus of opinion among their staff that the incidence of complaints against CRPs was "minute" and had "not created any problem in the various bureaus."⁵

CONSUMER COMPLAINTS REGARDING CRPs RECEIVED BY THE
BETTER BUSINESS BUREAU OF CANADA (BBB)

After a survey of its offices across Canada, the BBB indicated that the volume of inquiries and complaints in regard to CRPs was very light -- so light that they had not been recorded separately but rather included in a catch-all category from which no real breakdown was available. The BBB spoke of "very few customer complaints, all of which have been satisfactorily adjusted." The BBB did mention that there was some greater activity for two tax seasons prior to 1978 in the area of income tax discounters. The implication, however, seems to be that these complaints related to the practice of purchasing tax refunds at a discount rather than to return preparation services per se, although one imagines that the undervaluation of refunds could involve improper computations.⁶

CONSUMER COMPLAINTS REGARDING CRPs RECEIVED BY THE
FEDERAL DEPARTMENT OF CONSUMER AND CORPORATE
AFFAIRS (CCA)

The Consumer Affairs Division of CCA has supplied some data to the POC which is found in Tables 2 and 3 (following). Table 2 contains gross figures for the category of "Accountants and Tax Consultants" during the 1973 to 1977 period. Table 3 provides brief summaries of the total of 35 complaints received in that category by the Consumer Services branch office in Ottawa for the same period.⁷

Again, four reservations apply to this data. Firstly, complaints concerning tax agents, accountants, bookkeeping firms, consultants and in at least one case the DNR are aggregated in Table 2. The same is true for Table 3, although there one can at least discard those references which obviously do not involve CRPs. (Note that none of the complaints in Table 3 seem to refer to tax discounters.) Secondly, the subject-area breakdowns employed in Table 2 are not further defined. Listings will therefore probably reflect the complaint agents' judgment of the nature of the problem. Thirdly, the summaries provided in Table 3 are very incomplete. In a large number of instances no resolution of any kind is indicated. Whether this reflects lack of follow-up by the complainant or the CCA, lack of information, unsubstantiated allegations or simply an inability to resolve those complaints within the four means provided in the summary codes is not clear. Fourthly, the data in Table 3 is necessarily sampled, coming from only one office (although the office will receive complaints from all regions). If the set of 35 sample complaints is taken as representative, one could guess that the proportion of CRP-related

complaints found therein will be reflected in the gross figures found in Table 2.

Keeping such reservations in mind then a few general observations can be stated. Turning first to Table 2: Complaints are assigned to a number of discrete categories. Of these, "goods/services/payment not received" is consistently the largest -- representing 50 out of the 127 complaints recorded (almost 40%). This is followed in size by "alleged unethical practices" (28 complaints) and "prices" (25 complaints). All other categories record less than 10 complaints each over five years, with "guarantees and warranties" accounting for only 2 complaints in total. The yearly total of complaints grows from 13 and 17 in 1973 and 1974 respectively to roughly double that amount in 1975 (28 complaints), 1976 (39 complaints, the peak year) and 1977 (30 complaints). The largest number of complaints received in a single category in one year was 17 for "goods/services/payment not received" in 1976. The next highest was 12 "alleged unethical practices" complaints in the same year. Of course, no indication is given in Table 2 as to whether any of the complaints recorded were substantiated.

Turning to Table 3: It is possible to eliminate at least 9 of the 35 complaints as clearly unrelated to CRPs. Of the remaining 26 complaints there is room for doubt in some cases as to whether an accountant, bookkeeper or CRP was involved. There are at least 5 complaints relating to price and price advertising problems (approximately 25%). Perhaps 11 complaints (roughly 50%) can be said to concern "errors," or what the complainant perceived to be an error in preparation. Of that 11, 2 allege that deductions were omitted, another that a tax return was remitted by the DNR because it

was illegible. One complainant alleged a discrepancy of over \$1,400 between the rebate as calculated by a CRP and the amount actually owing to the DNR. Outside of the 11 error-related complaints, 2 additional complaints relate to an alleged failure to return documents to the client. One complainant simply registered his or her objection to "unlicensed people who present themselves as accountants or tax consultants." Whether this involved a CRP is unknown.

Such anecdotal evidence is probably not deserving of very much weight, particularly as the summaries only indicate in 8 out of the total of 35 cases whether the complaint was confirmed, unsubstantiated or referred either to the Combines Branch of CCA or some other agency. It is perhaps noteworthy that one company (H. & R. Block) accounts for 8 out of 26 possible CRP-related cases. However, at least 5 other cases contain no indication of the firm involved. Obviously, too, H. & R. Block may be most visible in Table 3 -- if 8 complaints can be called visible -- because it is the largest organization in the market (see supra).

On the whole, the most interesting figure generated by the CCA data lies in the ratio of CRP-related complaints to the total number of consumer complaints recorded. Table 2 indicates that 30 complaints were recorded for all of Canada in 1977. Even assuming (which the summaries in Table 3 do not support) that all 30 complaints concerned CRPs, this would represent .0005355 of the approximately 56,000 complaints received by CCA in 1977.⁸

SOURCE: COMPILATION PREPARED BY CONSUMER
SERVICES SECTION, MINISTRY OF CONSUMER AND
CORPORATE AFFAIRS

RECORD OF COMPLAINTS HANDLED BY THE CONSUMER SERVICES ACTIVITY
OF CONSUMER AND CORPORATE AFFAIRS CANADA

Subject: Accountants & Tax Consultants

Year/Prov.	Complaint Advertising	Alleged Unethical Practices	Goods/ Services/ Payment not received	Guarantees & Warrantees	Prices	Quality	Misc.	Total
1973								
N.B.						2	2	4
Que.		1	2		1			4
Ont.			1					1
Alta.			2		1			3
B.C.			1					1
	0	1	6	0	2	2	2	13

RECORD OF COMPLAINTS HANDLED BY THE CONSUMER SERVICES ACTIVITY
OF CONSUMER AND CORPORATE AFFAIRS CANADA

Subject: Accountants & Tax Consultants

Year/Prov.	Complaint Advertising	Alleged Unethical Practices	Goods/ Services/ Payment not received	Guarantees & Warrantees	Prices	Quality	Misc.	Total
1974								
Que.	1		1					2
Ont.	1	2	4		3	1		11
Man.			1					1
Alta.		2						2
(U.S.)		1						1
	2	4	7	0	3	1	0	17
sub-total	2	5	13	0	5	3	2	30

RECORD OF COMPLAINTS HANDLED BY THE CONSUMER SERVICES ACTIVITY
OF CONSUMER AND CORPORATE AFFAIRS CANADA

Subject: Accountants & Tax Consultants

Year/Prov.	Complaint Advertising	Alleged Unethical Practices	Goods/ Services/ Payment not received	Guarantees & Warrantees	Prices	Quality	Misc.	Total
1975								
Que.		5	5	1	3	1		15
Ont.	1		2		2			5
Man.			1					1
Sask.		1	1					2
B.C.					4		1	5
	1	6	9	1	9	1	1	28
sub-total	3	11	22	1	14	4	3	58

RECORD OF COMPLAINTS HANDLED BY THE CONSUMER SERVICES ACTIVITY
OF CONSUMER AND CORPORATE AFFAIRS CANADA

Subject: Accountants & Tax Consultants

Year/Prov.	Complaint Advertising	Alleged Unethical Practices	Goods/ Services/ Payment not received	Guarantees & Warrantees	Prices	Quality	Misc.	Total
1976								
Nfld.			3		1			4
N.S.			3					3
Que.		4	4		2		1	11
Ont.		4	2		2		1	9
Man.		2	4					6
Alta.		1			2			3
B.C.	1	1	1					3
	1	12	17	0	7	0	2	39
sub-total	4	23	39	1	21	4	5	97

RECORD OF COMPLAINTS HANDLED BY THE CONSUMER SERVICES ACTIVITY
OF CONSUMER AND CORPORATE AFFAIRS CANADA

Subject: Accountants & Tax Consultants

Year/Prov.	Complaint Advertising	Alleged Unethical Practices	Goods/ Services/ Payment not received	Guarantees & Warrantees	Prices	Quality	Misc.	Total
1977								
Nfld.			1					1
N.S.					1			1
N.B.		1	1			1		3
Que.	1							1
Ont.	2	2	1	1		1		7
Sask.			2				1	3
Alta.	1	2	3		3		1	10
B.C.			2				1	3
(U.S.)			1					1
	4	5	11	1	4	1	4	30
TOTAL	8	28	50	2	25	5	9	127

<u>Date Rec'd./ Prov.</u>	<u>Complaint</u>	<u>Against</u>	<u>Conclusion</u>			
			<u>A</u>	<u>B</u>	<u>C</u>	<u>D</u>
11/72 Ont.	After husband's death mix-up in tax returns & Canada Pension filed by consultants for 1968.	Farm Business Consultants		x		
12/72 Ont.	Tax accountant told him cheque for return from last yrs. claim just waiting signature from special officer.	Income Tax Dept.	x			
01/73 Que.	Had accountant draw up balance sheet -charged \$800 yet job not like it should be.			x		
05/73 Que.	Income tax sent back saying -Entry Illegible- Completed by firm and feels it should be legible.	H & R Blok [sic] Co.	x			
05/73 Que.	Thinks something done wrong in income [sic] tax returns -Didn't enter social ins. no., etc.	Maxi-Tax				x
05/73 Que.	Receiving notice of assessment from Incom [sic] Tax Serv. after paid door to door man for filling out income [sic] tax forms	C & A group of Companies				
06/73 Alta.	Paid \$8. this year for filling income tax instead of usual \$5.	H & R Bloi [sic]		x		
08/73 Ont.	Paid \$75. to have tax consultant do his income [sic] papers -Man never showed up.	C & A Group of Companies	x[?]			

Date Rec'd./ Prov.	Complaint	Against	Conclusion			
			A	B	C	D
08/73 B.C.	Had co. make out income tax returns. Never rec'd. refund. Then found Co. still had them waiting for his signature.	Richard Crawford & Co.				x
08/73 Que.	Feels overcharged to get incom [sic] tax filled in.	Robert Sauve				x
02/74 Ont.	Co. adv. \$5. minimum charge to fill in incom [sic.] tax -Ont. & Man. res. pay \$3. extra. No mention in ad.	H & R Block				
03/74 Ont.	Not given copy of tax rætturn when Co. filled form.	Simpsons-Sears				
04/74 Que.	Paid to have Incom [sic] Tax filled in -Not done yet.					
04/74 Ont.	Co. prepared income tax return incorrectly.	H & R Block				
04/74 Que.	Adv. said \$5.00 to do income tax. Was charged \$11.00.	H & R Block				
05/74 Ont.	Accountant has customer sign forms & cheques for tax due before papers are complete.	Mr. A. Kalbfleesh				

Date Rec'd./ Prov.	Complaint	Against	Conclusion			
			A	B	C	D
08/74 Ont.	Sent incom [sic] tax return form to co. to have filled in -Didn't get them back.	B.D.B. Tax Service				
09/74 Ont..	Feels charged too much to have 4 income tax forms filled.					
10/74 Ont.	Paid tax consultants but they never did any work -won't give him refund for monies paid.					
01/75 (California)	Feels neglected to put a lot of deduction [sic] while preparing tax returns.					
03/75 Que.	H. & R. Block owe them money made a mistake -on form- Now they won't pay up.	H. & R. Block				
04/75 Ont.	Hired book keeper -feels was overcharged for amount of work he did.					
05/75 Que.	Audit group won't accept him but he pays their annual dues.					
06/75 Que.	Paid in advance to have income tax done -finally got their file copy no originals to file	Ottawa Valley Tax Consultants				

Date Rec'd./ Prov.	Complaint	Against	Conclusion			
			A	B	C	D
07/75 Que.	Co. made error on incom [sic] tax return -they refuse to pay the difference.	Verrier Richard Hebert Cie.				
07/75 Que.	Had Co. do tax return -said rebate of \$848- now gov't. wants additional \$617.	H & R Block				
07/75 Que.	Had Co. do Income tax return paid them 6\$ [sic] forms were filled all wrong.	Omega Travel Bureau				
09/75 Ont.	Paid for new bookkeeping system -comes 4 x a yr -accountant din't shop [sic] up.					
12/75 Ont.	Chartered acct. claiming to incorporate Co's for \$250 & registered solicitor would charge \$700.	Bookkeeping Services Ltd.				
01/76 Que.	Unable to locate Co. -paid them to do his 74 & 75 returns -never filed them.	Ottawa Valley Farm Tax Consultants				
03/76 B.C.	Adv. on T.V. that Co. open all yr. round -not so.	H & R Block				
02/77 Ont.	Paid 396 in advance to have bookkeeping done -too many errors wants refund -has not heard from Co.	Farm Business Consult.				
03/77 Ont.	Told return would be \$206 -went to someone else- return was \$694 -too big a difference	S. and S. Tax Centre				

Subject: Accountants & Tax Consultants

A-confirmed B-unsubstantiated
C-ref. to Combines D-ref. elsewhere

<u>Date Rec'd./ Prov.</u>	<u>Complaint</u>	<u>Against</u>	<u>Conclusion</u>			
			<u>A</u>	<u>B</u>	<u>C</u>	<u>D</u>

04/77 Alta.	Obj. to unlicensed tax people who present themselves as accountants or tax consultants.				
07/77 (California)	Very poor service by accountant --was told didn't owe any income tax -really owes over \$2,000 <u>SOURCE: COMPILATION PREPARED BY CONSUMER SERVICES SECTION, MINISTRY OF CONSUMER AND CORPORATE AFFAIRS</u>	Mr. Barry Gorman			

NEWSPAPER SURVEY OF CRP PERFORMANCE

Consumer advice and assistance columns in our daily newspapers occasionally deal with disgruntled clients of CRPs. However, only one "major" article is listed in the Canadian Newspaper Index for the period from 1/01/77 to the present. The Index lists references to articles in eight major Canadian dailies which are judged by the compilers to be writings of lasting social-historical interest. That article (Toronto Star, 2/04/77) proclaims "10 of 10 income-tax firms flunk Star test." The substance of the feature article is described below.⁹

In March, 1977 a reporter was equipped with a fabricated identity, a set of financial figures and some dummy documentation (T4 reports of employment income). The figures were invented by a local chartered accountant. Based on the sums, the C.A. completed a tax return, arriving at a result of \$1,008.70 refund "owing" to the "taxpayer." The C.A.'s version of the return was also checked by two employees of Revenue Canada and confirmed as correct.

The invented data consisted of two T4 forms showing income from employment plus withholdings for Canada Pension, Unemployment Insurance, a registered pension plan, union dues and prepayment of income tax. The "taxpayer" stated he was a married high school teacher, with no children, and that his wife earned \$15,000 per year through employment. He had purchased a sailboat in 1975 and sold it at a

loss in 1976. He also owned a rental townhouse property which had operated at a loss, and certain equipment (stoves, etc.) located in the rental property. During 1976 the taxpayer had travelled to Japan to work on a book, and could both itemize his full expenses for the lengthy trip and prove his arrangement with a publisher. Finally, the "taxpayer" had purchased 7,000 shares in one company, in transactions stretching from 1969 to 1974, and had sold 5,000 of the shares in 1976.

As the headline proclaimed not one of the 10 CRPs visited by the "taxpayer" -- chosen from the Toronto telephone listings, and including major chains, department store agents and one-man operations -- reached the same results as the C.A. and the assessors at Revenue Canada. The errors are represented in Table 4 (following).

The fees charged ranged from a low of \$15 to a high of \$58 for the same return. The longest time spent in an interview with a CRP was one and one-half hours. In most cases the client had to return for the final copy, usually about one week after the interview. According to the article the actual preparers included a C.A. and former S.E.C. employee, a former ten-year employee of Revenue Canada, and one person who told the "taxpayer" she was a law student specializing in taxation.

Various parts of the calculation had different error rates. For example: all of the CRPs correctly stated that the loss on the sale of the boat was not deductible, and that no depreciation was

claimable on the rental townhouse. All correctly listed the expenses relating to the rental property, but only some correctly claimed a capital cost allowance on the rented equipment (a deduction). The purchase and sale of stock involved a calculation of pre-1972 and post-1971 values, to accommodate the institution at that date of capital gains tax. Nine out of ten did this incorrectly. One CRP calculated correctly, but made a mechanical error (misplaced decimal point) on that area of the return. All of the CRPs but one correctly included the Japan trip expenses; however of the nine, two omitted hundreds of dollars from the proper total of expenses (e.g. one omitted \$880 meal expenses).

The completed returns were again taken to Revenue Canada for analysis of the errors. The number of errors is shown in Table 5 (following).

The Revenue Canada assessors also gave the reporter some indication of whether or not the errors would have been noticed on the first, general audit (a basic check of calculations and documents) or only on a more thorough second audit (usually performed on returns chosen at random). Some examples: an error in the capital gains calculation for the stocks would generally only be discovered on second audit. Even this assumes that the transaction dates would be shown; in one case they were not. The omission by one CRP of the Japan trip expenses would never be caught, simply because it was not mentioned. Mechanical errors will be caught on the first audit so long as the correct figure appears somewhere on the form or the accompanying documentation.

The likelihood of Revenue Canada's spotting a given error was not indicated for every case. It is clear that many errors (whether favouring the taxpayer or the MNR) would be missed on the first audit, leaving only the hope that the return would be chosen for a second audit. The indications also confirm that a voluntary deduction which is completely omitted by the taxpayer and/or the CRP will not come to the attention of the MNR (unless subsequently discovered by the taxpayer).

On the whole, the newspaper article presents a very depressing picture. One reservation should, though, be stated. It seems that the reporter was equipped with a relatively complex return. The highest quantities of error related to (in descending order) the stock transactions, the rental property equipment and the business trip expenses. By "relatively complex" is not meant that the tax implications are extremely difficult for a trained person to understand. There may be some question, however, whether the average person using CRP services is a long-term stock owner, in the business of renting property or able to make deductions for self-employment expenses. The calculations relating to employment income, the sailboat (personal use property), etc. were pretty much correct in all cases. On the other hand, it should be reasonable to expect that many CRP clients will have some "complications" in their tax form beyond mere income-from-employment calculations, if not yearly then at least periodically.

Note: The article stated that 3 million Canadians use CRP services each year. No source for this assertion is indicated.

Table 4

NET ERRORS IN COMPUTATION

Correct sum \$1,008.70 refund in favour of taxpayer.

<u>No.</u>	Amount computed by CRP (R = refund O = liability)		<u>Error</u>
1.	R	1,038.39	29.69 excess refund
2.	R	1,135.50	126.80 excess refund
3.	R	1,135.50	126.80 excess refund
4.	R	1,243.60	234.90 excess refund
5.	R	1,011.50	2.50 excess refund
6.	R	1,034.80	62.10 excess refund
7.	O	741.20	267.50 excess liability
8.	O	361.22	647.48 excess liability
9.	O	907.10	101.60 excess liability
10.	O	46.86	1,055.56 excess liability

Source: Toronto Star Feature Article, April 2, 1977.

Table 5

NUMBER OF ERRORS PER CRP

<u>CRP No.</u>	<u>Errors</u>
1.	3*
2.	3
3.	1
4.	2
5.	2
6.	1**
7.	3
8.	2
9.	2*
10.	1

* included fact that the CRP listed the capital cost allowance but did not deduct it for that taxation year; this is legally permissible but probably not to the taxpayer's advantage

** misplacement of decimal point

Source: Toronto Star Feature Article, April 2, 1977

POTENTIAL ABUSES

It would of course be ridiculous to suggest a need for external regulation of CRP services without considering what the possible areas of abuse or dangerously low-quality service might be. So far as this writer can see, the following would seem to be the major areas of concern.

1. Improper advertising. This area is almost self-evident. Problems could arise concerning the advertising of prices, guarantees, availability of services, etc. Representations of quality, peculiar qualifications, etc. would be included here. The problem of improper advertising practices is, however, in no way confined to CRPs. It can be plausibly argued that advertising is already sufficiently regulated, by the Combines Investigation Act and Criminal Code at the federal level and by the Ontario Business Practices Act. There may be inadequacies of scope and application in the unfair advertising legislation, but this is not a specifically CRP-related difficulty. The real question, then, would be whether there are problems specific to CRP advertising that cannot be adequately dealt with under the present general legislation in this area, so as to require special treatment.¹⁰

Another advertising-related problem would arise if some regulatory regime based on registration, certification or licensure were considered -- that is, could representations of "approved" status act as potentially misleading forms of product differentiation? It is interesting that under the California registration-licensure scheme, CRPs are prohibited from

referring to their registered status in any advertising (see infra.).

2. Improper pricing. Unfair price advertising should be included under # 1, above. Other possible problems in this area would include price discrimination, overcharging, agreements in restraint of competition and so forth. The same considerations as apply to #1 can be raised here. Since the Combines Investigation Act now applies to "services" as well as goods, there should be no fundamental question concerning its use against trade conspiracies, price fixing, etc. by CRPs.¹¹

Other price-related problems, such as whether unrestrained price competition would drive high-quality providers out of the market, would not seem to be present in the CRP market. At least so long as CRPs confine themselves to the preparation of relatively simple returns for average wage earners, the cost of even the most complex task is not likely to be very high. This means that there is not much leeway for significantly large variations in price between CRPs -- certainly nothing comparable to, say, a lawyer offering uncontested divorce work for \$100 instead of \$600.

3. Unfair contracts. There is room for concern, as there is in insurance law, that the nature of the liabilities and duties in the CRP-consumer relationship can and will be adequately understood by the consumer and that important clauses will be fair in distributing loss risks between the CRP and the customer. Whether the use of deceptive guarantee provisions, etc. is in fact prevalent in the market is another question. There is some anecdotal evidence that some consumers misunderstand the import of a guarantee like that employed by Block, expecting that the CRP is undertaking to pay any tax owing beyond

the amount calculated by the CRP, but this does not seem to be widespread.

One problem with applying the general legislation covering consumer transactions -- the restriction of such acts to sales of goods -- has been somewhat alleviated in recent years. Whether there is sufficient need for further forms of regulation may be doubtful. At least one major rationale for the regulation of insurance contracts is that the beneficiary usually has a very long term reliance on the contract. One would not like the insured to discover fifteen years later that his insurance policy does not cover the situations he thought it did or that his coverage could be denied through poorly-comprehended technicalities. This form of long range reliance would rarely, if ever, arise for CRP consumers. Block indicated that there is the occasional problem with the consumer who alleges he has relied on Block's calculation to his detriment. Typically, such consumers claim that, on the strength of Block's calculation, they have devoted funds to some transaction that they would not have entered otherwise. When the DNR insists that the taxpayer owes much more than he expected, the taxpayer is understandably upset. Block noted that this problem is exacerbated by the human tendency to treat an expected refund as cash-in-hand. If the CRP initially calculates a refund of \$200 which is subsequently changed to a liability of \$200, some consumers tend to regard this as a "loss" to themselves of \$400. Block of course disclaims any liability for such reliance or "losses."¹²

It is not known whether such situations are sufficiently common to justify some special treatment of CRP guarantees so as to insure that they are easily understood and straightforward from the consumer's perspective.

4. Unethical behavior. Because CRPs become privy to financial information about their customers and because the preparer is likely to have superior knowledge about the services being provided, the possibility exists for CRPs to be involved in various forms of unethical behavior. The two primary dangers -- though certainly not the only ones -- would seem to be (i) disclosures of confidential information without the client's consent and (ii) the provision of unnecessary services. As examples of the former an adverse party in a court proceeding, or a creditor, might attempt to obtain financial information from the CRP, or the CRP might sell customer lists cross-referencing names and income levels. The scope of civil liability for such breaches is at the moment unclear, particularly in Ontario, which has no "invasion of privacy" statute similar to British Columbia's. (Note that the problem is not one of whether a court would extend a testimonial privilege to the client or the CRP.) Courts in Canada have been reluctant to recognize a compensable interest in personal privacy, particularly when no commercial exploitation of personality is involved. In order to totally eliminate this problem (if it in fact exists) it would probably be necessary to prohibit both disclosures and contractual provisions waiving the right to privacy.

Regarding the provision of unnecessary services, it should be noted that tax return preparation for the average person is not like (say) legal services. There is a distinct limit on the services required, which is a product of the tax system rather than of the judgment of preparer or client. The range in which the over-provider could operate would be relatively small -- e.g. charging for the preparation of schedules which are unnecessary for the particular taxpayer. Even if the CRP were to double the consumer's charge, this would seem to typically involve amounts under

\$50. (This should not be taken as minimizing the prejudice felt by the consumer, for whom \$50 may certainly feel like a significant sum.) The same considerations would seem to apply to the underservicing problem. The DNR's assessment should provide some relative quick feedback as to whether the taxpayer's return has been adequately filled out.

5. Illegal behavior. Illegalities would include fraudulent misstatements of fact, either to the client or the revenue authorities -- concealment of income, fraudulent deductions or forged supporting documentation and so on. Of course, such activities by either the taxpayer or the CRP are already subject to criminal sanction. It seems doubtful whether any form of additional sanction would improve present levels of honesty or whether any regulatory regime would make such practices more easily detectable. In contrast to the U.S. system, non-standard deductions in Canada must be supported by documentation accompanying the return. Persons who complete tax returns for remuneration have long been required to add their name, address and signature to the form. The only difference between prosecuting fraud perpetrated by a sole taxpayer and fraud where the return has been prepared by a CRP is the assignment of culpability between the two parties. Since the taxpayer himself must sign a declaration that the entries are to his knowledge accurate and complete he would seem to be primarily responsible in law for the tax return. In the circumstances of a particular case it may be a nice question as to the extent to which CRP and taxpayer are entitled to take each other's statements at face value. Since the mens rea for fraud is one of knowingness it is doubtful whether either party to the relationship could be liable for a failure to "suspect" the other's assertions unless he was being willfully blind to the other's fraud.

6. Negligence. One must consider the problem of both (i) negligent performance and (ii) negligent misstatement. The former would involve negligent omission of deductions, failure to include income, miscalculation, transposition of entries and misconstruction of relevant tax law. It seems that under general principles the CRP would be held to the standard of the average CRP in terms of skill and care. Whether a CRP can contractually limit his liability for negligent performance is not absolutely certain in law. It does seem that courts will construe any such provisions very strictly as against the service provider, and that the courts may be willing to apply the doctrine of "fundamental breach" [i.e. breach of an undertaking so central to the contract that it will be treated like total non-performance of the bargain] or the doctrine of "consideration" [i.e. if the contract is drafted so as to impose no duty at all on one party it may be treated as no contract] so as to preclude the operation of exclusionary clauses which purport to limit all liability for negligence. In addition, it must be considered what the compensable damages for negligent performance might be. The taxpayer who is ultimately required to pay the correct amount required by law has not suffered a "loss" as such in terms of tax dollars. His direct pecuniary loss would take the form of any interest or fine levied (e.g. for late payment) as a result of the CRP's error -- a loss which is presently covered by the Block guarantee. Aside from questions of assignment of fault under a guarantee like Block's, the real problem is whether a loss of expectation should be compensable.

This latter point raises the issue of negligent misstatements of fact. These may lead to civil liability for CRPs if the statement was made under such circumstances that (i) the making of such statements was part of the maker's usual activity, (ii) the maker knew or should reasonably have

known that the statement would be relied upon by the recipient and (iii) the statement was in fact relied upon by the recipient to his detriment. Expectation per se is not generally a proper subject of damages. However, it may take the form of concrete reliance -- such as when the taxpayer buys a colour television because the CRP has calculated that he is entitled to a rebate which is later repossessed when the calculation proves incorrect. Again, the question of whether liability for such negligence can be totally excluded by contract is unclear, especially since the law of negligent misstatement is itself in a still developmental stage.

7. Failure to perform duties. Assuming that the respective duties and liabilities of CRP and consumer are clearly established, there is always the possibility that the CRP could fail to complete his undertaking. This danger increases according to whether the failure to perform is relatively easy to conceal from the other party and relatively profitable for the CRP. It should be noted that, aside from the question of guarantees, the services themselves are fairly straightforward. The CRP contracts to forward, or at least prepare for forwarding, a complete tax return, including the necessary documentation supplied by the client. Failure to do so should be quickly indicated by the DNR's assessment procedures, and would seem to be a simple matter of contract. Concealment of a failure to perform is also therefore not easy.

8. Missed deductions. The problem of missed deductions properly belongs in the above paragraphs on negligence, failure to perform, etc. It is treated separately simply because it is probably the greatest source of potential prejudice to the consumer. Under our tax system the DNR does not undertake to determine for individual taxpayers their eligibility for

particular deductions. While the Income Tax Guides inform taxpayers about the available deductions and standards of eligibility, a blank space in the taxpayer's form is treated as if it were representative of the taxpayer's choice not to claim the reduction in tax liability. An example of this arose recently in Ontario, where the provincial tax system grants to all tenants a flow-through property tax credit based on a percentage of rent paid in the taxation year. Many eligible persons with incomes so low as to be untaxable fail to file returns. A publicity campaign was undertaken to inform such persons of the availability of the tax credit and the fact that it can not be obtained unless specifically claimed in an annual return. The obvious problem in relation to CRPs is to ensure that they canvas all the possible deductions with each client. Block (as one example) apparently tries to ensure this through training of preparers to recognize relevant situations and Block-designed forms which provide a checklist of possible deductions. Indeed, many CRPs attempt to sell their services by stressing that a CRP will be more knowledgeable about the range of available deductions than the taxpayer. It should be noted that in Canada the number of available deductions is really quite small for the person whose income is generated by employment, such that a checklist will not be very long or complex. (This should be contrasted to the U.S. where such things as the tax on cigarettes, the cost of work-related clothing and a mileage credit for use of a personal car in voluntary activities for social agencies have been at one time or another deductible if the taxpayer chose to itemize his deductions rather than take a blanket percentage of his gross income as his personal deduction.) (See infra.)

It may be doubtful whether this situation could be remedied through any feasible change in the DNR's assessment procedures. Whether negligent

omission liability for the CRP can be totally excluded by contract is also unclear. Subject to a limitation period, tax returns can be reopened to account for new data, so that if the error was discovered by the taxpayer within the limitation period it could be remedied. It is important to remember that there is small need for \$1,000 solutions to \$100 problems. This should not be taken as a suggestion that the possible prejudice is insignificant. Although it may be true that the level of financial "loss" to a taxpayer from an omission will be relative to his overall income level and that the average CRP customer is unlikely to come from the upper half of the income scale, it is equally true that the individual loss will be proportionately significant to each taxpayer and that lower-income earners make up a very large portion of the tax base. Thus, if a \$25,000 earner and a \$10,000 earner each omit a \$1,000 deduction that would cause their respective tax liabilities to decline by 1%, such that the former misses a saving of \$250 and the latter one of \$100, it is not necessarily permissible to say that the \$10,000 earner has suffered a less meaningful loss. Proportionately it may represent an equally significant loss -- if not a more significant prejudice because the lower-income earner can afford it less in terms of its impact on his disposable wealth.

9. Poor advice. As with missed deductions (which are a form of poor advice), this problem should be included under the headings of negligence, failure to perform, etc. It is treated separately because there is some real question as to the extent to which CRPs can said to be involved in the provision of tax advice in any real sense. Firstly, in as much as CRPs mainly serve wage earners, there would appear to be much less opportunity for judgmental, advisory

service. Simply, contentions on points of law and construction of the tax legislation seen far less likely to arise in that context than for a businessman, self-employed professional or corporation. Secondly, it cannot be said whether the average CRP client would typically call upon the CRP for any form of estate planning-type tax advice. Thirdly, it may be that, like H. & R. Block, CRPs avoid giving judgmental advice to their clients. Of course, a company policy might not be reflected in the actual activities of the individual preparers, who might indeed attempt to render advisory services. Obviously, the greater the amount of such services offered or undertaken by CRPs the greater will be the argument that they should be treated somewhat in the manner of professionals such as lawyers or architects. Estate planning-type tax advice is far more likely to generate long-range reliance by the taxpayer and substantial levels of possible prejudice for poor judgment on the part of his advisor. This would raise questions of the appropriate standard of care and skill for civil liability, whether mandatory insurance should be imposed, and so on.

REGULATORY APPROACHES

On the subject of whether some form of external regulation of CRPs is justified, the following basic questions (for which no conclusions are proposed) should be considered. Firstly, what are the potential dangers present in the market as it exists? Secondly, can these dangers be adequately covered by existing legislation? Thirdly, even if present law is in theory adequate to the task, are the procedural and cost difficulties involved in pursuing existing remedies such as to make them practically ineffective? For example, if the client could sue for \$20, would the cost of doing so be prohibitive, such that some other, less cumbersome, mechanism should be provided for his protection? Fourthly, if present law is inadequate can the problems be overcome by workable amendments to existing legislation or common law? Fifthly, if question four is answered negatively, is it possible to efficiently deal with special problems through specific enactments? Sixthly, if some form of special control is required, what is the best way to accomplish it? More particularly, which flawed special solutions are most preferable to the problems they are designed to remedy?

There are five possible approaches to the control of CRPs: (a) no special regulation (with or without changes in other areas of the law affecting CRP activities); (b) ad hoc regulation of specific activities; (c) registration of either or both of individual preparers or firms; (d) certification (as in (c)); and (e) licensing (as in (c)). The drawbacks associated with the various forms of regulation are so well documented

elsewhere that they will receive no exposition here. Suffice it to say that, on the principle of less-is-more, ad hoc regulation is probably the preferable form if possible. One fundamental problem with registration, certification and licensing (among many) is that they tend to confer or at least suggest a special status for those coming under the regulatory regime. This in itself, no matter how minimal the regulatory intervention was, would be a very large change from the present situation. Ad hoc regulation, on the other hand, seems to be far less problematic in this respect. In addition, ad hoc regulation is probably far more flexible, since it is less likely to create self-perpetuating status relationships or quasi-proprietary interests in a certain form of regulation.

THE AMERICAN EXPERIENCE

CRPs in the U.S. have received much more attention from a regulatory perspective, although concrete results have occurred in only a very few instances. The following passages describe briefly (i) the background against which such discussions have taken place; (ii) the U.S. CPA Association's proposal for federal regulation of CRPs; and (iii) the regulatory regimes adopted in California and Oregon in recent years.

Background

Two important points of contrast exist between the Canadian and American situation: (a) the much greater volume of returns prepared by CRPs in the U.S. and (b) the documentation and audit procedures used under U.S. tax law.¹³

In the U.S. H. & R. Block presently prepares 10 to 11 million individual tax returns each year, and has long exceeded its initial target of preparing 10% of the total of individual returns filed annually. Precise data on the market share of its many competitors is not available, but at least one recent (1978) survey suggests that on a national scale as many as 25% of all individual filers use CRP services. This is a significantly larger portion of the tax base than is serviced by CRPs in Canada.

There are significant differences in the approach of U.S. revenue laws and the Internal Revenue Service (IRS) which may go some way towards

explaining why so much more attention has been directed to questions of CRP regulation in America. Most important are that individuals, when taking itemized deductions rather than a flat percentage of their income, are not required to provide documentation of their expenses at the time of filing and that the IRS audits individual returns on a spot-check basis. Documentation of deductions is only required, then, when and if the taxpayer is subject to an IRS audit. Contrary to the DNR procedure of checking every tax return, the IRS conducts either (i) random-sample audits or (ii) audits of taxpayers whose totals and claims deviate significantly from predetermined normal curves. While such techniques may in fact lead to a high level of detection of improper returns, they at least psychologically encourage the belief that the chances of being "caught" are not great -- particularly if the tax cheater is careful to remain moderate in his dishonesty.¹⁴

Whether actually or psychologically the opportunities for abuse seem to be much greater under U.S. tax practice. This is exacerbated by the fact that there are still -- despite some recent reforms -- a large number of available personal deductions. Historically, it seems that the success of firms like H. & R. Block depended on this factor. Faced with the choice of either itemizing his deductions or taking a flat percentage deduction, the average wage-earning taxpayer frequently chose to take the latter. Block promoted its services by demonstrating that in very many instances the itemization approach lead to greater deductions and the CRP could complete this complex task for the taxpayer relatively inexpensively. For example, when cigarette taxes were deductible, Block prepared schedules which could convert cigarettes-per-day totals into the appropriate deduction very quickly; work-related clothing and tool expense deductions

were computed using lists of the types of expenditure (say) a welder might make in this area.

Until recently, it was also the situation in the U.S. that there was no enforced requirement for anyone other than the taxpayer to sign a return. It was therefore virtually impossible to know whether a CRP had prepared a given return instead of the taxpayer in many cases.

It seems that many forms of abuse became common. In the early 1970's the Federal Trade Commission was required to act in response to numerous complaints of unfair advertising practices by tax agents relating to prices, guarantees and so on. There were fears that some CRPs were attracting business by letting it be known that they could aid the client in "manufacturing" lists of itemized deductions. An apparent problem also arose with CRPs who used the information gained from clients to sell income-referenced mailing lists, or who too readily revealed financial information about their clients (e.g. to insurance companies or securities salesmen). In general concern was expressed that CRPs employed marginally competent preparers and, worse, often went out of business shortly after the tax season so as to be unavailable when the IRS questioned the return.

The CPA Proposal

In the 1970's federal regulation of CRPs has apparently been proposed a number of times. As one example, the American Institute of Certified Public Accountants (AICPA) made extensive representations in 1972 to the Legal and Monetary Affairs Subcommittee of the House Committee on Government Operations.¹⁵ The AICPA emphasized that revelations of abuses by CRPs would contribute to the "its OK to cheat on taxes" syndrome.

Problems associated with advertising, incompetence and unethical practices were singled out. The AICPA also suggested that the U.S. tax system should be simplified so as to reduce taxpayers' reliance on third party preparers. In summary form, the AICPA's recommendations were as follows:

(a) Require CRPs to file information returns listing all taxpayers for whom returns were prepared. This would allow the IRS to identify preparers and any patterns of abuse.

(b) Impose clear negligence penalties on CRPs, but with the burden of proof shifted to the IRS. This latter feature would be necessary to prevent making it impossibly difficult for CRPs to defend cases, forcing a defensive posture on CRPs, or allowing intimidation of CRPs by clients and the IRS.

(c) Provide for the power to allow applications by the revenue authorities for injunctions against CRPs who consistently prepare improper, false or deficient returns.

(d) Impose clear CRP-specific penalties for misleading advertising, with fines to be based on the volume of the CRP's business (e.g. \$5 times the number of returns prepared). A review procedure for "clearance" of advertising materials was also suggested.

(e) Impose penalties for failure on the part of the CRP to sign returns or provide its identification number.

(f) Require CRPs to make and retain copies of all returns prepared for a minimum of three years following the year of preparation.

(g) Extend IRS publicity programs to emphasize to taxpayers that they have the primary responsibility for filing proper returns and should accordingly be cautious in selecting a CRP. The AICPA also stated that taxpayers should not be too aggressively encouraged to complete their own returns because even simple forms contain complications that might be overlooked by the taxpayer.

(h) Upgrade the competence of CRPs, through cooperation with established educational bodies in developing training courses and continuing competence programs.

What the AICPA did not recommend is also of interest. Its submissions stressed that licensing or registration schemes [and presumably also certification schemes] would be unwieldy, very costly in relation to their benefits and generally ineffective in ensuring competence and integrity. It also cautioned against appearing to grant CRPs any quasi-official "status," which might be abused for promotional purposes by CRPs.

California's Regulatory Regime

At the federal level changes to the tax system affecting CRPs were adopted by regulation under the Tax Reform Act of 1976.¹⁶ These changes certainly do not seem to go as far as the AICPA's recommendations. Essentially, they provide for signature and preparer-identification requirements and certain standards of conduct in return preparation. The provisions themselves are not specifically directed to CRPs, but apply to all persons who prepare returns.

Much more extensive regulation, specifically directed to CRPs, was adopted in the State of California. These rules were instituted in two stages. In 1970 legislation was passed making it a misdemeanor for any person engaged in the business of preparing tax returns in the State to disclose any information obtained in the course of that business unless the taxpayer expressly consents in writing, the disclosure is authorized by law or made in response to a court order, or the disclosure is strictly necessary to the task of preparing the return.¹⁷

The passage of this act did not dispel other concerns, and in 1972 the California Department of Consumer Affairs commenced further studies. One of its public hearings was addressed by the California Society of Certified Public Accountants (CSCPA). The substance of the CSCPA's representations was as follows:¹⁸

(a) In 1972 it could be conservatively estimated that more than 25,000 CRPs were carrying on business in the State. Perhaps 50% of citizens in the State were using some form of assistance in preparing their returns.

(b) Anecdotal evidence indicated consumer complaints relating to (i) excessive charges; (ii) mass production techniques and lack of individualization of returns; (iii) "fly-by-night" CRPs who were no longer in existence when returns were challenged by the revenue authorities or consumers sought to have guarantees honoured; and (iv) the use of marginally competent employees.

(c) Licensing of CRPs would create immense costs and administrative problems and would give an appearance of increased status to licensees with no guaranteed assurance that that status was deserved in terms of competence and integrity.

(d) Ad hoc regulation of specific problem areas was the preferable procedure.

(e) Taxpayers should be educated to their primary responsibility for their tax returns and selection of third party preparers, such that the taxpayer himself may be considered at least partly responsible for later problems if he seeks cheap low-quality service. More information should be available to taxpayers to allow them to complete their own returns or to have recourse to their legal remedies when a CRP provides incompetent services.

Ultimately, the California legislature adopted the present Chapter 20.6 of the Professions and Vocations Code (Stats. 1973, c. 870),¹⁹ a mandatory registration law known as the Tax Preparers Act. The Act appropriates funds for the establishment of a regulatory regime under the supervision of the Director of the State Department of Consumer Affairs, who operates it through the Chief of the Division of Consumer Affairs. The latter is granted power to administer the act, investigate violations of the rules and so on.

P. 9891.1 defines "Tax preparer" as follows:

(a) "Tax preparer" means a person, other than an employee who, as part of the regular clerical duties of his employment, prepares his employer's tax returns or an employee, representative, partner, agent, officer or member of a registered tax preparer, who, for a fee, assists with or prepares tax returns for others. A franchisee of a tax preparer is a separate tax preparer subject to the provisions of this chapter. [Emphasis added.]

This general definition is slightly wider in scope than the pool of tax preparers who are subject to the Act. While p. 9891.20(a) states that

"every tax preparer" shall be registered, p. 9891.2 provides that:

The following persons are exempt from the requirements of this chapter:

- (a) Any person regulated by the State Board of Accountancy.
- (b) Any person who is a member of the State Bar of California.
- (c) Any trust company or trust business . . .
- (d) Banks regulated by the state or federal government.
- (e) Any person who is authorized to practice before the Internal Revenue Service pursuant to . . . the Code of Federal Regulations.

All tax preparers not exempted by p. 9891.2 are required to register at least annually with the Department, which maintains a registry containing names, addresses, a registration (identification) number and any other data the Chief may require. The registration scheme is given its mandatory effect by p. 9891.24, which enacts that,

. . . it shall be unlawful for any person to be a tax preparer unless such person is registered in accordance with the provisions of this chapter. Any person who violates this section is guilty of a misdemeanor punishable by a fine of not less than fifty dollars (\$50) or more than five hundred dollars (\$500), or jail for a period of not more than 60 days, or both, for each violation of this section.

P. 9891.25 then provides the following grounds upon which the Chief may refuse to accept, suspend or cancell a registration (inter alia):

. . . for any of the following acts or omissions relating to preparing tax returns for others for a fee which are done by the tax preparer or any employee, representative, partner, agent, officer or member of the tax preparer:

- (1) Making, or authorizing the making of, any statement or representation, oral or written or recorded by any means, which is intended to induce persons to use the tax preparation service of the tax preparer, which statement or representation is fraudulent, untrue, or misleading.
- (2) Obtaining the signature of a customer to a tax return or authorizing document which contains blank spaces to be filled in after it has been signed.
- (3) Failing or refusing to give a customer, for his own records, a copy of any document requiring his signature, within a reasonable time after the customer signs such a document.

(4) Failing to maintain a copy of any tax return prepared for a customer for the applicable statutes of limitation periods.

(5) Engaging in any fraudulent conduct.

(6) Violating the advertising provisions set forth in this chapter.

.

(10) Failing to post the proof of valid registration, supplied by the chief, in each tax preparer location.

(11) Failing to sign a customer's tax return as proscribed by the Chief.

Subsection (b) of p. 9891.25 provides in addition that the Chief may refuse, suspend or revoke, temporarily or permanently, the registration of a tax preparer "if he enters a plea of guilty or nolo contendere to, or if he has been convicted of, a felony or a crime of moral turpitude, and the time for appeal has elapsed or the judgment of conviction has been affirmed on appeal"

The "advertising provisions" referred to in p. 9891.25(a)(6) are found in p. 9891.37, which provides that no tax preparer shall in any way make reference to his registered status in any advertising medium whatsoever. (This does not include the posting of the notice of registration required by the Act.)

According to p. 9891.27, when the Chief determines that a registrant has violated the Act he may serve an accusation on the tax preparer, who is then entitled to a hearing at his request. Aside from suspending or cancelling the tax preparer's registration, two other remedies are available: voluntary assurances of compliance by the tax preparer and judicial injunctions. The Chief may only accept a voluntary undertaking of compliance on condition that (i) the tax preparer pays all investigative costs incurred in discovering the alleged violations up to a maximum of \$500 and (ii) the

registrant undertakes to establish operating procedures which will prevent future violations. In addition, the Chief has power to impose additional conditions "as ... may be necessary to protect the public interest and to protect the interests of those persons for whom the registrant has prepared tax returns" (p. 9891.27(b)(2)). The Act also explicitly provides that the expiration of a registration does not deprive the Department of investigative and disciplinary jurisdiction over the (former) registrant. Judicial injunctions are provided for by p. 9891.31, which empowers the Superior Court to enjoin any tax preparer for violations of the act. Injunctive proceedings are commenced by the Chief, but also require the prior approval of the Director of the State Department of Consumer Affairs.

Finally, two other provisions deserve mention. Firstly, p. 9891.32 expressly states that the existence of the sanctions in the Act in no way operates to deprive any individual of the right to bring a civil action against a tax preparer. Secondly, p. 9891.35 provides that each registrant must post a bond, as follows:

A tax preparer shall deposit with the division, prior to registration or registration renewal, a cash or surety bond in the penal sum of one thousand dollars (\$1,000). The bonds required by this section shall be payable to the people of the State of California, and shall be conditioned that the person applying for registration or registration renewal will comply with this chapter and will pay all damages occasioned to any person by reason of misstatement, misrepresentation, fraud, deceit or any unlawful acts or omissions by the tax preparer or its agents or employees while acting in the scope of their employment or agency. The aggregate liability of the surety shall in no event exceed the penal sum of the bond.

Considered as a whole the California legislation provides two fundamental things. Firstly, it allows for ready identification of CRPs operating in the State. The registry requirements may deter

unstable operations and should allow for easier detection of patterns of abuse. Secondly, the disciplinary and injunctive remedies allow the state to prohibit the operation of CRP services by persons who have failed to comply with basic standards of record-keeping and conduct -- placing some risk upon CRP firms who fail to supervise either company activities or the activities of their employees and agents.

Although mandatory registration acts as a kind of general licensing, it is most important to note that the California law does not contain two elements commonly found in professional regulatory regimes. Firstly, the Act does not attempt to define "return preparation" in any way. Secondly, the Act does not prescribe minimum standards of skill, continuing competence, training and so on. The Act, in other words, in no way attempts to regulate quality in its usual sense. Indeed no provision even exists for refusing or removing the registration of a CRP on the basis of (say) repeated findings of civil liability against the CRP for negligence. Given the apparent intention of the state to avoid entering the area of competence evaluation, the ban on references to registered status -- which might have been used for promotional purposes -- seems intelligent, especially since it is provided that the CRP must post notice of his registration in his place of business.

Oregon's Regulatory Regime

The State of Oregon has taken a quite different approach from that of California. ORS 673.305 - 673.990 of the State Code (Tax Consultants and Tax Preparers) imposes a scheme of licensure.²⁰ As will be seen, many features

of the Oregon scheme resemble those found in the self-regulated professions in Ontario.

The Act distinguishes between "tax consultants" and "tax preparers," providing that (per 673.615):

(1) A person shall not prepare or advise or assist in the preparation of personal income tax returns for another and for valuable consideration or represent that he is so engaged unless he is licensed as a tax consultant . . . [Emphasis added.]

(2) A tax preparer may prepare or advise or assist in the preparation of tax returns only under the supervision of a tax consultant.

Under 673.643 a corporation or partnership may render such services through licensed personnel, so long as it submits an annual report identifying its authorized officers and employees.

Exemptions from licensure are provided for the following persons:

1. full-time or permanent employees preparing returns for their employer's business only; 2. lawyers; 3. trustees and administrators of estates; 4. certified public accountants; and 5. state, local and federal government employees acting in the course of their duty. A recent opinion prepared by the State Department of Justice states that (i) preparation of corporate (as opposed to "personal") returns is not covered by the Act, and (ii) constitutionally, persons authorized to practise before the I.R.S. need not (and it seems cannot) be licensed under Oregon law with respect to that practice. Employees of exempt persons, however, must be licensees. Finally, persons preparing any returns without remuneration are exempt by implication from the wording of 673.615.

The Act is administered by the State Board of Tax Service Examiners, of the Department of Commerce. Applicants for licensure must satisfy the Board that:

1. in the case of tax preparers, they are 18 years of age, possessed of a high school diploma, have successfully completed at least 60 hours of accredited instruction in basic personal income tax law, theory and practice, and have successfully completed the Board's entrance examination; and

2. in the case of tax consultants, in addition to the above, they have been actively employed and licensed as a tax preparer for at least two years, and have completed a Board examination of a more exacting nature on personal income tax law, theory and practice.

The Act also allows the Board to waive its examination requirements for transferees who have already been licensed in a jurisdiction with a substantially similar licensure requirement and for persons who are already enroled to practise before the I.R.S. (Note: the first waiver applies to preparers and consultants, while the second applies only to applicants for a consultant's licence.)

Paragraph 673.655 imposes a mandatory continuing education requirement. Subject to a special waiver for unusual or extenuating circumstances,

. . . each person licensed as a tax consultant or preparer . . . shall submit evidence . . . that he has completed at least 60 classroom hours of instruction in personal income tax subjects during the three-year period immediately preceding the date on which the evidence is submitted.

It should also be mentioned that, while the continuing education requirement is spaced over three-year intervals, licences must be renewed annually. Each

licensee must display a copy of his licence at his place of business or employment.

The Board of Examiners must be composed of persons licensed as tax consultants and possessing at least five years of practical experience in the field. The Board has power to determine qualifications, set and grade examinations, prescribe fees, investigate alleged violations of the Act, and propound a code of professional conduct. In addition, the Board acts as the disciplinary body for CRPs, with power to revoke, suspend, refuse or refuse to renew a licence, or to reprimand any licensee for (inter alia):

- a) violation of paragraph 673.705 (below);
- b) gross negligence or incompetence in practice;
- c) conviction of a felony or misdemeanour involving moral turpitude;
- d) conviction of willful failure to pay taxes, file a return or keep required records, fraud, or falsification of documents under the tax laws of any state or the Federal government;
- e) failure to maintain the continuing education required; and
- f) violation of the code of professional conduct prescribed by the Board.

Paragraph 673.705 prohibits (inter alia) willfully making a false oath, attempting to obtain or use a licence under false pretences and unauthorized representations of licensed status. The procedure on disciplinary actions is not specified in the Act.

Finally, 673.735 provides that, in addition to any other penalty, a fine of up to \$1,000 may be levied in respect of a violation of any provision of the Act or any rule adopted thereunder. The alleged offender may appeal from notice of a penalty by requesting a formal hearing before

the Board, which may remit or mitigate any fine as it deems proper in the circumstances.

While the substitution of exclusive licensure for mere registration is the most salient difference between the California and Oregon regulatory regimes, a few other points of distinction may be noticed. Only the California regime explicitly prohibits unauthorized disclosure of information by CRPs (see p. 53, above). The Oregon Act contains no restrictions on advertising (see p. 56, above). While under both regimes the CRP is required to keep a record of returns prepared, only California's statute contains further provisions relating to documentation -- such as the rule that CRPs cannot ask the client to sign an incomplete form and the requirement that the client be provided with a copy of his return (see p. 55, above).

It may be that the above, and similar, matters can be dealt with under the Oregon Board of Examiner's code of professional conduct. [Note: correspondence with the State Attorney-General's office did not reveal that there is at present an existing code of professional conduct under the Act.] In this respect, the California Act appears to be much more "public" in orientation than the Oregon law. On comparative examination, it also seems clear that the California scheme provides a more flexible mix of controls and sanctions (e.g. cease and desist orders, voluntary undertakings, etc.) than the Oregon Act.

It appears that there is no real information yet available on the experience to date under either regulatory regime. It is therefore

impossible to say whether administrative action against CRPs has been extensive or minimal under either statute. It may say something about the Oregon provisions to note that ORS 673.605 - 673.990 has been extensively amended and added to twice (in 1975 and 1977) since it was added to the State Code in 1973. However, whether these were merely "cosmetic" changes or reflected substantial difficulties in the operation of the licensure system cannot be discerned from the information available to this writer.

Note: An overview of the Federal provisions respecting CRPs preparing Federal personal income tx returns will be found in an Appendix to this document.

SOME SUGGESTIONS FOR FURTHER INQUIRIES

1. A much better understanding of the structure of the market for CRP services would seem to be required before any questions of whether or not some form of regulatory intervention is warranted could be seriously answered.

2. A far more detailed knowledge of what the average CRP does and does not do in performing his services would increase the ability to evaluate levels of, and needs for, quality control.

3. Some indication of substantial problems relating to quality, advertising, etc. beyond the existing evidence on consumer complaints would be useful. Unfortunately, consumer complaints seem to be inherently unreliable indicators, primarily because (1) consumers may or may not be able to perceive whether they have received adequate services (in terms of quality and price); (2) consumers who can make knowledgeable price-quality judgments may or may not know where to complain; and (3) even if problems (2) and (3) are not present, consumers may believe that it is not "useful" to register their complaints. Problem (1) may not be quite so large in relation to CRP services as it might be for (say) legal or architectural services. The DNR's individual assessment procedures should often provide quick feedback on inadequacies in return preparation. Still, there are some difficulties -- the example of missed deductions being the most obvious -- and in general the unreliability of consumer complaints as a basis for drawing conclusions cannot be discounted.

4. A comprehensive legal and practical evaluation of existing rules of statutory and common law which either do or might have some

application as deterrents or remedies for CRP-related problems would be necessary in order to reach any conclusion on whether further special legislation might be required.

Appendix: U.S. FEDERAL LEGISLATION AFFECTING CRPs

History

Substantial federal interest in CRPs commenced in 1971, with the introduction of a Congressional Bill which would have required the Secretary of the Treasury to promulgate standards for ethical conduct, entry qualifications and practice for CRPs. The initial bill was followed by hearings, a further draft proposal presented to the House Ways and Means Committee, and finally by the amendments adopted in the Tax Reform Act of 1976 (H.R. 10616, 94th Congress, Public Law No. 94-135).²¹

Prior to 1976, the IRS had concentrated on attempts to detect fraudulent practices by CRPs and to audit CRP-prepared returns to insure their accuracy. In addition, in 1971 the IRS informally entered into a project with the FTC aimed at eliminating misleading advertising and other deceptive practices in the CRP field. The FTC subsequently issued a number of orders against CRPs for such activities.

Under the state of the law prior to 1976 there was little control of CRP activities. While CRPs were generally required to sign tax returns, there was no penalty for failure to do so. Most penalties in the IRS Code were directed to improper practices by the taxpayer himself, rather than a paid preparer. Individual taxpayers were (and are)

liable to a criminal fraud penalty (maximum \$10,000 and/or five years imprisonment) for willful attempts to evade tax and to civil penalties (maximum 50% of understated tax) for underpayment as well as for negligent or intentional disregard of rules and regulations (equal to 5% of unpaid tax). CRPs, on the other hand, were subject only to criminal fraud liability for aiding and abetting the fraudulent preparation of a return.

Considerations leading to the new policy

In the past two decades the number of CRPs and their clients has increased greatly. In 1972 an estimated 35 million taxpayers sought some form of professional or commercial assistance. In the same year it was estimated that about 250,000 persons were engaged in the business of preparing tax returns. It was apparently common for many CRPs to engage in questionable practices --including such things as "guaranteeing" refunds (thus giving the preparer an incentive to deliver on the guarantee by "doctoring" the return) and having clients sign blank returns (thus depriving the taxpayer of the chance to review his return before filing). In 1972 and 1973 the IRS conducted surveys of preparers suspected of such improper conduct. In 1972 the IRS concluded that 60% of some 5,000 returns examined showed "fraud potential"; in the 1973 survey, which was based on a more random selection, 22% of the 6,000 returns examined showed

"fraud potential." Under then existing law, the IRS found it difficult to police such abuses, since the criminal sanctions available were inappropriate, cumbersome and ineffective deterrents, involving great expense and time. Thus, only the most flagrant abuses were subject to prosecution.

Present policy was also influenced by a 1975 report prepared by the General Accounting Office. The study indicated that CRPs did not have a significantly greater tendency to make mistakes than individual taxpayers, and that they are no more likely to make larger mistakes. It was felt that this was attributable to the fact that most CRPs were involved only with relatively uncomplex, "household" returns. These findings led the legislature to conclude that CRPs should not be singled out, but rather subjected to regulation applicable to all tax preparers.

The present law

Definition of CRP. The rules apply to any person who, for compensation, prepares all or a substantial portion of a tax return for another, regardless of the educational standing or professional status of the preparer. Exemptions from the rules are provided for (a) those who render merely mechanical services (typists, etc.), (b) employees who, as part of their regular services, prepare returns for their employer or fellow employees, (c) preparers of returns for trusts or estates of

which the preparer is a fiduciary, and (d) persons preparing a refund claim pursuant to an IRS audit.

Disclosure rules. CRPs must include on every return their identification number and signature. Failure to do so is subject to a \$25 penalty. The preparer must retain either a copy of all returns or a list of all taxpayers served for a period of three years. There is a \$50 penalty for each failure, with a maximum fine of \$25,000 for each year. Reasonable cause and absence of willful neglect will be a defence. Employers of CRPs must file an annual list of their employees, subject to a penalty of \$100 for each missed filing and \$5 for each omission from a filing, with a maximum fine of \$20,000 per year. All CRPs must return a copy of the completed return to the taxpayer-client. Failure to do so carries a \$25 fine, with reasonable cause or absence of willful neglect again providing a defence. The information gathered under these procedures will be made available by the IRS to any State agency involved in licensing, registering or otherwise regulating CRPs.

Negligence and fraud penalties. The Act institutes a penalty of \$50 per return for negligent or willful attempts to understate tax liability. A \$100 penalty is assessed for all intentional or negligent disregard of the federal tax laws, rules and regulations. A bona fide dispute as to legal interpretation would not qualify as such an offence. These penalties apply to the individual CRP; the employer will

not be liable unless he personally engages in the offense as well. There is a second penalty of \$500 where a CRP disregards information supplied by a taxpayer in an attempt to reduce tax liability. This last offense is not subject to the usual three-year limitations period.

The normal procedure for enforcement will be as follows. An IRS investigation will be made, and the CRP will be given 30 days to pursue administrative remedies prior to any penalty assessment. The IRS can then impose an assessment, which the CRP can appeal by paying the assessment and filing a refund request. If the refund request is denied, the CRP may appeal to a U.S. District Court.

In any court proceedings on the merits, the IRS has the burden of proving willful understatement of liability. The CRP bears the burden of disproving fault on a procedure relating to negligent or willful disregard of the tax laws.

Regardless of any appeals, the penalty assessed will be cancelled and returned to the CRP if it is judicially or administratively determined that there was in fact no understatement of liability or disregard of the law.

In addition, it should be mentioned that the Act adds a \$500 civil penalty against any CRP who endorses or negotiates a cheque issued by the IRS to the taxpayer with respect to any

tax return prepared by the CRP. This seems to prohibit the CRP from acting as a tax refund discounter as well in relation to the returns he has prepared --at least so long as he attempts to have the refund endorsed over to him or placed under his control by a power of attorney. Presumably the CRP could act as a simultaneous CRP and discounter if the premium for early payment (i.e. the charge the discounter makes in return for advancing the refund to the taxpayer before it is paid out by the IRS) were made in cash.

Injunctions. Under the new Act, the Secretary of the Treasury is empowered to seek injunctions prohibiting a CRP from either (a) engaging in specific acts or (b) acting as a CRP at all, on the grounds that the CRP has:

1. engaged in conduct subject to penalties under the Act;
2. engaged in conduct subject to criminal penalties under the Internal Revenue Code (i.e. criminal fraud);
3. misrepresented his eligibility to practice before the IRS;
4. misrepresented his experience and education as a CRP;
5. guaranteed the payment of any tax refund or allowance of any tax credit; or
6. engaged in any other type of fraudulent or deceptive practice similar to numbers 1 through 5 which substantially intereferes with the proper administration of the revenue laws.

Thus, the new penalties introduced under the Act serve a dual purpose, since they may act as grounds for an injunction. The CRP may avoid injunctive action by posting a \$50,000 bond as surety for any penalties.

FOOTNOTES

1. Record of interview with Mr. W. Green, Regional Director of H. & R. Block (Canada) Limited. On file with the POC, under Tax Agents II. Correspondence.
2. Data on file with the POC, under Tax Agents III. Statistics.
3. Per a survey conducted for H. & R. Block Ltd. in the U.S. (July, 1978). On file with the POC, under Tax Agents III. Statistics.
4. See "Statement of the California Society of Certified Public Accounts: At Hearing on Income Tax Preparers conducted by the California Department of Consumer Affairs (February, 1972)." On file with the POC, under Tax Agents I. General.
5. Correspondence from Mr. R. Lewis, Ontario Ministry of Consumer and Commercial Relations, Business Practices Division (February, 1978). On file with the POC under Tax Agents III. Statistics.
6. Correspondence from Mr. T.G. Trimmer, Operations Manager, Better Business Bureau of Canada (January, 1978). On file with the POC, under Tax Agents III. Statistics.
7. Data on file with the POC, under Tax Agents III. Statistics.
8. Correspondence from Mr. M. McCabe, Assistant Deputy Minister, Consumer and Corporate Affairs, Consumer Affairs Division (February, 1978). On file with the POC, under Tax Agents III. Statistics.
9. "10 of 10 income-tax firms flunk Star test," Toronto Star (April 2, 1977) pp. A-1 and A-12. On file with the POC, under Tax Agents III. Statistics.
10. Combines Investigation Act, R.S.C. 1970, c. C-30, as amended. The Business Practices Act, S.O. 1974, c. 131.
11. See n. 10, ante.
12. See, e.g., The Business Practices Act, n. 10, ante. It is uncertain whether that Act would apply to CRP Services, since "services" are defined by s.1 (i) as "(i) provided in respect of any goods or of real property, or (ii) provided for social, recreational or self-improvement purposes, or (iii) that are in their nature instructional or educational." It seems that "itinerant sellers" of CRP services would fall under the Consumer Protection Act; R.S.O. 1970, c. 82, as amended. The practice of income tax discounting (i.e. purchasing future refunds at a reduced rate from tax payers) would be regulated by The Income Tax Discounters Act, S.O. 1977, c.55. (Bill 10: An Act to amend the Discounting of Income Tax Refunds Act received third reading in April, 1978.)

13. See n. 1, ante.
14. Revenue Canada uses a two-stage procedure. All forms are given a first rudimentary audit (for calculation and documentation). More thorough second audits are given where problems are evident and also at random as spot-checks. Under the American system the first scrutiny may often not proceed beyond the final totals found on the front page of the return.
15. Skinner, R.G., "Statement on Proposed Legislation to Regulate Tax Return Preparation," The Tax Advisor (June, 1972) 349 - 352. On file with the POC, under Tax Agents I. General.
16. Record of conversation with Mr. M. Yecies, Internal Revenue Service (August, 1978). On file with the POC, under Tax Agents II. Correspondence.
17. See n. 4, ante.
18. Ibid.
19. Tax Preparers Act, Stats. Calif. 1970, C. 870, as amended. A copy of this Act is on file with the POC, under Tax Agents IV. Statutes. Similar regulatory legislation has been enacted in the State of Oregon, which should be compared.
20. Information supplied by Mr. G.F. Bartz, Assistant Attorney General (January, 1979). On file with the POC, under Tax Agents IV. Statutes.
21. Information supplied by Mr. Jerome Kurtz, Commissioner of the Internal Revenue Service (October, 1978). On file with the POC, under Tax Agents IV. Statutes.

